GATT : a primer for parliamentarians

Background Paper

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# THE GATT:
# A PRIMER FOR PARLIAMENTARIANS



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# THE GATT: A PRIMER FOR PARLIAMENTARIANS

## INTRODUCTION

To many the GATT is an obscure international agreement that deals with trade issues far removed from everyday lives and concerns. International trade, however, means jobs and prosperity so it is desirable to understand how it is regulated. This paper outlines the main features of the GATT and explains its operation. Recurring phrases in the context of GATT are shown in bold. A glossary containing these and other important trade terminology is appended, together with a bibliography for those wishing to pursue the subject in greater depth.

## WHAT IS THE GATT?

### A. How the GATT Came To Be

In the aftermath of the depression and World War II, the world reorganized itself politically and economically. The United Nations was formed to deal with political and security issues. In Bretton Woods, a small New England town, the Allied powers in 1944 considered what economic arrangements would govern the post-war world and signed the **Bretton Woods Agreement**.

Bretton Woods was the foundation for three major international economic institutions: the **International Monetary Fund** (IMF), the **International Bank for Reconstruction and Development** (IBRD or the World Bank) and the **International Trade Organization** (ITO).

The **General Agreement on Tariffs and Trade** (the **GATT**) is a 1948 agreement between trading nations that was designed to provide stability until the ITO could be set up. The ITO Charter failed to achieve the necessary support, however, primarily because the U.S. Congress during the Truman administration refused to ratify it. As a result, the ITO died but the GATT carried on, doing a job it was not initially designed to do. Over time the GATT has grown in membership and complexity, but there is still no ITO. It should be remembered that, whereas the ITO would have been an international institution with a large bureaucracy and extensive rule-making authority, the GATT is really just a contract between trading States. In this sense, the structure of the GATT is unlike that of most of the other United Nations institutions.

### B. Who Belongs to the GATT?

Twenty-three countries, including Canada, signed as the original **Members** of the GATT. GATT membership has now grown to 108 countries and includes most industrialized and developing countries. The former Eastern Block countries are knocking at the door of the GATT, while a substantial number of countries not yet within the GATT nevertheless apply GATT principles in their trade dealings. The **European Community** (EC), although not a State, is involved in the GATT.

### C. Who Is Important?

GATT talks are dominated by three major economic powers: the U.S.A., Japan and the EC. To combat this dominance, Canada has joined with other substantial agricultural producers to form the **Cairns Group,** which presents a united front at GATT agricultural negotiations to advance its common position.

The dissolution of the Soviet Union presents a new challenge to the GATT. Russia is the largest trading nation outside the GATT system and may form a new major GATT negotiating unit with its former **COMECOM** partners, once these nations are fully participating. As well, tremendous economic growth in the **Newly Industrializing Countries** (NICs), with

their large populations and export-oriented economies, suggests that these countries may soon exert influence at GATT negotiations.

## WHAT DOES THE GATT DO?

The preamble of the GATT sets out lofty goals such as raising living standards, and ensuring full employment and a large and steady growth of real income. In fact, the GATT is really involved with more mundane matters of trade.

### A. Basic Roles of the GATT

Essentially, the GATT is a forum in which countries can discuss how to reduce barriers to trade, how to resolve trade disputes, and what general rules should oversee international trade. In addition, the GATT is involved in Third World development through having some special rules and less onerous obligations that apply to the less developed countries.

### B. What the GATT Does Not Include

The GATT deals only with trade in goods and does not at present cover trade in services, which, however, forms a large part of world trade and is growing much faster than the trade in goods. The exclusion of services seriously undermines the GATT's ability to achieve its objectives, so reaching an agreement on rules to govern the trade in services is a GATT priority. The 1991 **Dunkel Report** of GATT Director General Arthur Dunkel contains a proposal for an agreement on services.

The GATT is intended to cover all goods; however, the existence of the **Multi-fibre Arrangement** (MFA) system of import quotas on textiles, which is in violation of the GATT, and the extensive application of agricultural subsidies in many countries, has largely put textiles and much trade in agricultural products outside effective control by the GATT.

## PRINCIPLES OF THE GATT

GATT principles are simple, although often misunderstood. The GATT does not say that there should be free trade in goods. It does not even say that Members should reduce **tariffs**, although it does generally prevent tariffs from being raised; in fact they have been reduced from an average of almost 50% to under 10% under the influence of the GATT.

GATT law comes down to three principles: no Non-Tariff Barriers (NTB), Most Favoured Nation Treatment (MFN) and National Treatment (NT).

### A. No Non-Tariff Barriers

A fundamental principle of the GATT is that open, visible tariffs should be the only barrier to trade in goods. **Non-tariff barriers** (NTBs) to trade, such as subsidies, technical barriers, quotas and **voluntary export restraints** (VERs) are generally prohibited. Disguised quotas, such as import licence requirements and State trading monopolies, are also regulated. Import fees are permitted, but these must approximate the cost of the customs service rendered, otherwise they are deemed to be a tariff. Tariff barriers are preferred over non-tariff barriers because they are visible and can more easily be compared.

There are exceptions to the rule. NTBs protecting a nation's balance of payments are permitted, as are temporary NTBs ("safeguards"), which may be implemented if a reduction of a tariff causes or threatens serious injury to a domestic producer. Quotas on agricultural products, such as Canada's supply management system, are, for the moment, also exempt. There are also exceptions to deal with the protection of public morals, human and animal life, exhaustible natural resources, materials in short supply and goods relating to national security.

### B. Most-Favoured-Nation Treatment

The second principle relates to the reduction of tariffs. Once a **concession** reducing a tariff is granted to one Member, that concession must be granted immediately and unconditionally to like products coming from all Member countries. That is, a Member must treat all Members as well as it treats its **most-favoured-nation** (MFN). This non-discrimination

in tariffs levels the field between competing foreign suppliers and ensures that all Members benefit from the trade negotiations.

There are limited exceptions to the MFN principle. If two-thirds of the Members approve, the GATT permits a Member to extend preferential treatment to particular nations. An example of this is the **Generalized System of Preferences** (GSP), which is granted to the less developed countries.

### C. National Treatment

Preventing discrimination in tariffs would be quite hollow if, once the product was inside the country, it could be discriminated against. GATT prevents this by application of the third fundamental principle, which requires that States provide **national treatment** (NT) in laws relating to the internal sale, transportation and use of the product. National treatment means that the foreign product must be treated in the same way as the like domestic product. For example, provincial liquor stores that preferentially provided more shelf space to Canadian wines than to foreign wines would be violating national treatment. Government procurement of products not intended for resale is exempt from the GATT national treatment obligation.

## PRACTICAL APPLICATION OF GATT RULES

### A. The GATT Negotiation Process

When NTBs have been converted to their tariff equivalent, the stage is set for GATT negotiation rounds to proceed. Negotiation rounds are extensive, ongoing meetings that tend to focus on the major problems of the day. The latest negotiation round, the **Uruguay Round**, began in 1986 and is still ongoing. Apart from reducing tariffs, the Uruguay Round has concentrated on reviewing trade in intellectual property, trade in services and agricultural subsidies. Previously, the Tokyo Round (1973 to 1979) dealt largely with obtaining codes to better regulate various NTBs that States were increasingly using. The earlier Kennedy Round (1964 to 1967) succeeded in obtaining major tariff reductions, and the Dillon Round (1960-1961) concentrated on dealing with the (then) new EC and its tariff barrier. Negotiation rounds, once

named after individuals (e.g., U.S. President John Kennedy and U.S. Secretary of State Douglas Dillon), are now named after the place where a new negotiation round is announced.

During negotiation, States typically offer to reduce a tariff in exchange for some reciprocal concession of equivalent value. The new lower tariffs are recorded in the GATT **tariff schedule**. Evaluating proposed concessions is a difficult, time-consuming process. The nature of the concessions is up to the Members, and can affect narrowly defined products or sweeping sectors of the economy. Groups of Members together may offer a concession.

MFN complicates the granting of concessions because a conceding State must also consider the value of the benefit it is granting, through the MFN principle, to other Members who are not required to give anything in return. The result is that negotiations are dominated by a few big players with other States waiting for advantages to come their way through MFN treatment.

### B. Dispute Resolution

The GATT may act only upon a complaint by a Member; it cannot initiate its own investigations. A complaint usually takes the form of an allegation of the "nullification or impairment" of a benefit under the GATT. The complaining Member must first attempt to resolve the problem through consultation, for which adequate opportunity must be given. If consultation fails, the GATT dispute resolution mechanisms may be used.

The GATT initially lacked serious dispute resolution procedures, but these developed in an *ad hoc* manner over time. Early GATT disputes were simply settled by a chairman's ruling. Later, "working parties" were set up, seeking a practical solution for each individual complaint. Eventually, the present system developed, where a **GATT Panel** hears the dispute.

Disputing parties request the appointment of a Panel, which will be established, unless the request is deemed to have been made for some vexatious reason. Panel members act in their individual capacity, are chosen largely because of their technical expertise, rather than for overt geo-political considerations, and are not usually drawn from the major economic powers or the disputing parties. The Panel forwards a report with recommendations and rulings

to the Council of the GATT. If the Council adopts the report, a reasonable time is provided for its implementation.

### C. Trade Retaliation

Despite the GATT, problems can arise. Until a GATT Panel can make a finding, Members will want to be able to take action to protect their interests. By permitting such retaliation, but within a tight system of rules, the GATT decreases the likelihood that countries will create NTBs that might undermine the entire GATT operation. The GATT permits retaliation in two circumstances: **dumping** and **subsidization**.

#### 1. Anti-Dumping

Dumping is a form of predatory pricing. It occurs when a product is sold in a foreign market at less than its normal value in the exporting country. Dumping may be an attempt to develop a market presence or, in some cases, to eliminate other producers from the market by putting them out of business through introducing low prices they cannot match. Products sold abroad for less than their cost in their country of origin (making allowance for differences in taxation, etc.) are clearly being dumped. If this dumping causes or threatens material injury to the importing country, then an **anti-dumping** duty (AD duty) may be imposed, the value of which is limited by the **margin of dumping**.

#### 2. Countervail

Some countries, either directly or indirectly, provide subsidies for the manufacture, production, transportation or export of their products and thus cause or threaten material injury to producers of like products in importing countries. In such cases, the GATT permits the importing country to impose a **countervail duty** (CV duty) against the subsidized product. Countervailing duties cannot exceed the value of the benefit conferred by the subsidy.

What constitutes a subsidy is always contentious; though the GATT contains a **subsidies code**, negotiators were unable to agree on an effective and comprehensive definition of the term. Of interest to Canadians is the fact that GATT Article XVI defines subsidies to include any form of income or price support.

## GLOSSARY OF TERMS

### Anti-Dumping Code

1979 subsidiary agreement between some GATT Members defining dumping, how injury to domestic industries is determined and how AD duties may be imposed.

### Anti-Dumping Duty (AD Duties)

Duties that are permissible under GATT Article VI(2), provided that the goods "dumped" cause or threaten material injury to an established industry or retard the creation of a domestic industry.

### Article XI

Fundamental GATT provision generally prohibiting quotas, but providing exceptions that accommodate Canada's system of supply management in agricultural products.

### Article XXIV

Provision allowing States to give preferential tariffs to specific countries if this is done with respect to substantially all the trade in products between the countries. The Canada-U.S. FTA, the not-yet-ratified NAFTA and the EC's Common Market are examples.

### Balance of Payments

Net difference between payments owed to other countries and payments owed by other countries.

### Bretton Woods Agreement

July 1944 international agreement negotiated under the auspices of the United Nations Monetary and Financial Conference; it came into force in December 1945. Bretton Woods sets the foundation for the IMF, the World Bank and the never-established ITO.

### Cairns Group

Fourteen exporters of agricultural products (including Canada, Australia, Argentina and Brazil) which formulate and advance common proposals on agriculture at GATT negotiating rounds.

**Codes**

Agreements, usually signed by some but not all Members of the GATT, which supplement the principal GATT document and deal with specific problems that these nations consider to be inadequately dealt with by the GATT. See anti-dumping code and subsidies code.

**COMECOM**

International trade agreement and organization amongst the former Eastern Bloc countries.

**Concessions**

Voluntary reductions in tariffs granted by one GATT Member to another, usually in exchange for a concession of similar value. Under the MFN principle, concessions are extended to all other GATT Members.

**Countervail Duties (CV Duties)**

Duties, permissible under the GATT Article VI(3), designed to offset the impact of subsidization.

**Director-General**

Chief officer of the GATT, who oversees the GATT secretariat. The office is at present occupied by Arthur Dunkel.

**Domestic Subsidies**

An NTB; this is in violation of GATT principles, but is permissible if other Members are informed of the extent, nature and estimated effect of the subsidy. Compare to export subsidies.

**Dumping**

Selling a product in a foreign market at less than its normal value in the exporting country. Countries can combat dumping through the imposition of anti-dumping duties.

**Dunkel Report**

December 1991 report by the Director-General which attempts to resolve many of the ongoing conflicts threatening the success of the Uruguay Round.

**Duty**

Tariff or tax due upon import or export of a good or service.

**European Community** (EC)

At present 12 European States which, under the *Treaty of Rome*, have advanced economic integration. Internal barriers to trade are to be removed by the end of 1992.

**Export Subsidies**

An NTB prohibited under the GATT for developed countries, except in some circumstances involving primary products. Incentives are given for the production or transportation of goods destined to be exported. An NTB may generate a countervailing duty in retaliation.

**GATT Panel**

Panel of trade experts acting in their individual capacity to facilitate a just resolution of trade disputes referred to it by Members.

**GATT Secretariat**

Administrative offices of the GATT; located in Geneva, Switzerland.

**General Agreement on Tariffs and Trade** (GATT)

A trade agreement between many countries, which deals specifically with goods; in force 1 January 1948. The GATT sets rules for international trade.

**Generalized System of Preferences** (GSP)

Special tariff treatment accorded to Developing Countries under Article XXV of the GATT, in which lower tariffs or less onerous trading conditions are imposed.

**Infant Industry**

Industry in the initial stages of development or operation that is accorded special protection through NTBs until it is established.

**Injury**

Ill-defined socio-economic damage to public or private domestic entities. Existence or threat of "material" injury is the test for imposition of AD and CV duties. "Serious" injury is the test for safeguard actions.

**International Bank for Reconstruction and Development**

The IBRD or World Bank, based in Washington, assists the economic development of member countries by making loans or giving loan guarantees to governments or private enterprises.

**International Monetary Fund (IMF)**

Organization based in Washington and promoting trade expansion and monetary cooperation and providing a system of international currency transactions.

**International Trade Organization (ITO)**

Intended third arm of the Bretton Woods troika: the IBRD, IMF and the ITO. It was designed in the 1947 Havana Charter, but failed to materialize because the Charter received an insufficient number of State ratifications.

**Margin of Dumping**

Difference between the normal value of a product imported and the lower price for which the exporter sells it. Often the difference between the price in the country of origin and the country of sale, with allowances made for taxation differences, etc.

**Members**

Nations for which the GATT or a GATT Code is in force; more properly referred to as "contracting parties."

**Mid-term Review**

A meeting part-way through a GATT negotiation round to consider progress to date. The mid-term review of the present Uruguay Round took place in Montreal in December 1988.

**Most-Favoured-Nation Treatment**

GATT Article I provision requiring that tariff concessions to any Member be immediately and unconditionally offered to like products from all other GATT Members.

**Multi-Fibre Arrangement** (MFA)

A still operative international agreement dating from 1974 which violates the principles of the GATT and establishes a system of import quotas for textiles. Canada is a party to the MFA.

**National Treatment**

GATT Article III prohibition on discriminatory practices in taxation or regulation between domestic and imported products.

**Negotiating Groups**

Discussion groups at GATT negotiations focusing on specific problems in international trade.

**Negotiation Round**

Ongoing, multilateral discussions between the GATT Members, usually lasting several years, in which tariff concessions and trade policy are negotiated.

**Newly Industrializing Countries** (NICs)

The NICs, consisting of the "Asian Tigers" of Korea, Singapore, Taiwan, Thailand and Hong Kong, plus Brazil and Mexico, are countries experiencing rapid economic growth through industrialization.

**Non-Tariff Barriers** (NTBs)

Barriers to trade, such as quotas, technical standards, licensing requirements or government procurement practices, that discriminate in law or in practice against potential foreign suppliers.

**Orderly Marketing Arrangement** (OMA)

Restrictions on trade that contravene the GATT. They usually come about when powerful developed nations seek concessions from NICs or Japan rather than unilaterally imposing restrictions on the foreign producer. See also VERs.

**Safeguards**

Permissible retraction or alteration of a previously agreed-to tariff concession as a result of the existence or threat of serious injury to domestic producers. A State facing the removed concession may seek compensation.

**SIMA**

The *Special Import Measures Act*; a Canadian statute implementing GATT provisions on subsidies, countervail and anti-dumping.

**Subsidization**

An ill-defined term to describe direct or indirect benefits conferred by a state upon it own producers and which are likely to increase exports or decrease imports of like products. It may lead to imposition of CV duties by another country to which the subsidy threatens material injury.

**Subsidies Code**

1979 subsidiary agreement between some GATT members detailing how CV duties may be imposed.

**Tariff**

Tax or duty payable upon foreign goods or service upon importation.

**Tariff Equivalent**

Open, visible tariff which has the same effect as the NTB it replaces.

**Tariff Schedule**

Detailed listing of applicable tariffs under the GATT system as negotiated at each successive negotiation round; an integral part of the GATT.

**TRIM**

Trade-Related Aspects of Investment Measures; a proposed international agreement on TRIM was made by the Director-General in the Dunkel Report.

**TRIP**

Trade-Related Aspects of Intellectual Property; a proposed international agreement on TRIP was made by the Director-General in the Dunkel Report.

**UNCTAD**

United Nations Conference on Trade and Development; U.N. agency with very wide membership concerned with coordinating trade and development policies.

**Uruguay Round**

The GATT negotiation round begun in Punta del Este, Uruguay in September 1986 and continuing into 1992.

**Voluntary Export Restraints** (VERs)

Agreements between nations, in violation of the GATT, on the restriction of exports between them. VERs have the same effect as an import quota.

**World Bank**

Alternative term for the International Bank for Reconstruction and Development.

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